THE RIGHTS OF STOCKHOLDERS WITH REFERENCE TO THE MANAGEMENT OF A CORPORATION.—PART II.

3. *Cases in which appeal to corporate agencies is not a prerequisite.*

But it is not to be supposed that this rule, though strict, is invariable. The cases show that if the aggrieved members can demonstrate that an appeal for redress within the corporation is hopeless, the courts will not compel them to delay their suit until a directors' meeting or a stockholders' meeting can be held for the purpose of making a demand, which, it is shown, would be futile. They may disregard such a formality and sue at once. Some of the cases state the rule to be, that if the directors are unable or unwilling to act, that will be sufficient without applying to the corporation. Others, and with better reason, hold that all the channels of corporate action must be shown to be closed. Thus, in *Rogers* v. *Agricultural Works*,[1] it was held that the plaintiff need only show that it was useless to make a demand on the directors because they were under the control of the president, whose wrongful acts were the subject of the complaint.

In *Currier* v. *R. R. Company*,[2] it was said that, "A stockholder . . . of an insolvent corporation may maintain an action against the corporation, its directors and other persons, to rescind an unlawful contract made by certain of the defendants with the corporation, without first making a demand on the corporation to bring an action to redress the wrongs complained of, where it appears from the facts alleged that the corporation is obviously unable to act by reason of its directors being under the control of the very persons who are alleged to have been guilty of the wrongful acts and who are made defendants in this action."[3]

[1] 52 Ind. 296 (1875); Sears *v.* Hotchkiss, 25 Conn. 171 (1856); Deadrick *v.* Wilson, 8 Baxt. (Tenn.) 108 (1874).

[2] 35 Hun. 355 (1885).

[3] Suffice it, for the present, to say that it is held, where the bill sets out acts *ultra vires* the corporation, inasmuch as such acts are beyond

In *Hersey* v. *Veasie*,[1] the defendant was the principal stockholder of a corporation which owned booms and locks on a certain river; he was treasurer, took the tolls, and had possession of all the corporate funds. He had obtained fraudulent judgments against the company; he had the franchise sold and would not account to plaintiffs nor allow them to inspect the company's books. It was alleged that he controlled, by proxy, a majority of the shares of stock so that no meeting of stockholders could be called. It was held that no relief could be given in this action because, under the laws of Maine, a general meeting of the corporation could be called by a minority, and the plaintiff did not show that it would be impossible, at a meeting so called, to have appropriate action taken.

In *Brewer* v. *Boston Theatre Company*,[2] the first bill filed charged that a majority of the directors were acting in the interest, and were under the control of, the persons charged with acts fraudulent as against the corporation. It was held that the allegation was not sufficient to support the bill. The amended bill showed that defendants had conspired fraudulently to lease the corporate property to some of their number, and that the majority of the stockholders were conspiring, knowing the fraud, and intending to keep said defendants in control. This bill was held sufficient without any resort to formal action within the corporation.

One of the earliest cases dealing with such actions in the United States was *Dodge* v. *Wolsey*,[3] decided in 1855. In that case, a citizen of Connecticut, the complainant, was a stockholder of the defendant company, which was organized to do a banking business under the laws of Ohio. A tax was

the power of the corporation to affirm or sanction, it is not necessary that the stockholder should aver that he has applied to the corporation, or its board of directors, to bring the suit and that they have refused: Salamons *v.* Laing, 12 Beav. 377 (1850); Heath *v.* Erie Co., 8 Blatch. 347 (1871), at p. 410; Colman *v.* Railway Co., 10 Beav. 1 (1846); Bagshaw *v.* E. U. R. Y. Co., 7 Hare, 114 (1849). This question will be discussed under the general head of *ultra vires* acts, *infra.*

[1] 24 Me. 9 (1844); Ware *v.* Bazemore, 58 Ga. 316 (1877).

[2] 104 Mass. 378 (1870); Mussina *v.* Goldthwaite, 34 Tex. 125 (1866).

[3] 18 How. 331.

levied on the bank by a statute of Ohio, which was claimed to be unconstitutional because a violation of the charter contract between the bank and the state. The bill alleged that plaintiff had requested the directors to bring suit to have the tax declared void, but that they, while admitting the illegality of the tax, refused to bring an action, on the ground that it would be more trouble than it was worth. An injunction was asked against the collection of the tax. This was granted, the court being of opinion that the refusal on the part of the directors to bring an action was a fraud and a breach of trust.

It will be observed that it does not appear from the case that any effort was made to appeal to the corporation at large, nor is there any averment that such appeal would be useless. The case was a very broad one, and opened the door to a flood of litigation in the Federal courts, wherein it was only necessary to show that appeal had been made to the directors and met by a refusal; whereupon plaintiff was given the right to enforce corporate rights against third parties, by suit in his own name.[1]

It will be seen, therefore, that the rule laid down in this case was not nearly so strict as that of the English courts and that of the better decisions of state courts in this country. The result was that whenever a corporation wished to bring a given cause of action, which it possessed against a stranger within the jurisdiction of the Federal courts, it would simply call in one of its stockholders who resided in another state, or transfer a few shares of stock to some one living outside the state of its incorporation, have him make a formal demand on the directors to bring suit on such cause of action, and, upon a refusal, bring the suit in his own name.[2]

This state of affairs was terminated by the decision of *Hawes* v. *Oakland*,[3] and the adoption by the Supreme Court of the United States of Equity Rule No. 94 as a consequence of that case.

In *Hawes* v. *Oakland*, complainant, a citizen of New York,

[1] Hardon *v.* Newton, 14 Blatch. 376 (1878).

[2] But see Morgan *v.* R. R. Co., 1 Woods, 15 (1870).

[3] 104 U. S. 450 (1881).

alleged that he was a stockholder in the X company; that the company was furnishing water under a contract to the City of Oakland, and that the city demanded, and the company's directors supplied, water for purposes not contemplated in the contract, and for which the city had no right to demand water, to the damage of the stockholders, and that it had wholly refused to desist from such practice. The directors did not answer, but the City of Oakland filed a demurrer as to the capacity of complainant, in himself, to maintain the suit.

Mr. Justice Miller, after adverting to the abuses which had grown out of the decision in *Dodge* v. *Wolsey*, *supra*, examined the English cases on the subject and deduced the following rule as applicable to the case at bar: "But, in addition to the existence of grievances which call for this kind of relief, it is equally important that before the shareholder is permitted in his own name to institute and conduct a litigation which usually belongs to the corporation, he should show, to the satisfaction of the court, that he has exhausted all the means within his reach to obtain within the corporation itself the redress of his grievances, or action in conformity to his wishes. He must make an earnest, not a simulated, effort with the managing body of the corporation to induce remedial action on their part, and this must be made apparent to the court. If time permits or has permitted, he must show, if he fails with the directors, that he has made an honest effort to obtain action by the stockholders as a body, in the matter of which he complains. And he must show a case, if this is not done, where it could not be done, or it was not reasonable to require it."

He adds with reference to the practice in the United States courts the following: "The efforts to induce such action and the cause of failure in these efforts should be stated with particularity, and an allegation that complainant was a shareholder at the time of the transactions of which he complains, or that his shares have devolved on him since by operation of law, and that the suit is not a collusive one to confer on a court of the United States jurisdiction in a case of which it could otherwise have no cognizance, should be in the bill, which should be verified by affidavit." [1]

B. Cases in which Equity will Entertain a Bill.

It is apparent, from the cases already adverted to, that the rights of stockholders in their individual capacity, even in courts of equity, are circumscribed to a degree. The cases in which a chancellor will take cognizance of their complaints form the exception, not the rule. Thus far it has been the effort to outline the pre-requisites and conditions with which a plaintiff must comply in order to have any standing in court. The cases now to be taken up deal with the substantive grounds which call for the interposition of a court of equity—granted that complainant is a properly qualified person to bring the suit. The cases are not susceptible of easy classification, and much of what is to be said on this point will doubtless have been involved in the cases heretofore cited or suggested by what has been said with reference to them. Many of these contain *dicta* bearing on the substantive rights of the stockholder, but it has been thought best to cite them only for the points decided, and to reserve for discussion, under this head, such cases only as have granted the relief prayed.

Subject to the limitations already mentioned, it is believed that the cases fall roughly under three heads, viz:

[1] The following "Additional Rule of Practice in Equity," No. 94, was promulgated by the Supreme Court, January 22, 1882; see Vol. 104 U. S. Reps., Preface IX:

"Every bill brought by one or more stockholders in a corporation, against the corporation and other parties, founded on rights which may properly be asserted by the corporation, must be verified by oath, and must contain an allegation that the plaintiff was a stockholder at the time of the transaction of which he complains, or that his share had devolved on him since by operation of law; and that the suit is not a collusive one to confer on a court of the United States jurisdiction of a case of which it otherwise would not have cognizance. It must also set forth with particularity the efforts of the plaintiff to secure such action as he desires on the part of the managing directors or trustees, and, if necessary, of the shareholders, and the causes of his failure to obtain such action."

For decisions under this rule, see Dimpfel *v.* Ry. Co., 110 U. S. 209 (1884); Taylor *v.* Holmes, 127 U. S. 489 (1887).

1. Fraud, either of directors or a majority of stockholders.

2. The embarkation, or attempted embarkation, in a new enterprise by the majority of the stockholders.

3. Acts *ultra vires* the corporation, done by the directors or a majority of the stockholders.

1. *FRAUD.*

It is the purpose to consider, under this head, only acts of fraud or oppression within the corporation. It is, of course, conceivable that an act fraudulent as to the stockholders may be, at the same time, an act *ultra vires* the corporation. But such cases will be treated under the head of *Ultra Vires Acts*, *infra*.

Fraud is always a reason for the intervention of courts of equity. It may be said that their jurisdiction is as broad as is fraud. Fraud has innumerable forms, and in every one of them equity will relieve against it at the suit of stockholders, where injustice would be done by withholding relief. This fact led Sir George Jessel to say, in generalizing, after speaking of the right to bring a bill for an *ultra vires* act: "But that is not the only case. Any other case, in which the claims of justice require it, is within the exception."[1]

In any case, therefore, where it appears that fraud has been practiced in the formation of the company—so that certain stockholders are imposed upon and cannot help themselves by reason of the arrangements made by the promoters of the corporation and perpetrators of the fraud—equity will relieve.

Such a case was *Atwool* v. *Merryweather*.[2] In that case plaintiff brought his bill, on behalf of himself and all the other stockholders in the East Pant Du Mining Company, except the persons who were defendants, against M and W and the company to have a contract for the sale and purchase of certain mines (for the purpose of working which the company was formed) set aside, and compelling repayment from M and W of £3900 and a return of the 600 shares of stock which had been allotted to M.

[1] Russel *v.* Water Works Company, L. R. 20 Eq. 474 (1875), at p. 482.

[2] L. R. 5 Eq. 464, n. (1867).

It appeared that in 1863 M and W published a prospectus of the formation of the company. For the purchase of the mines it was stated the company had arranged to pay £7000—£4000 to be paid in cash and £3000 in the stock of the company. A number of shares of stock were taken, and the money realized therefrom paid to M; and 600 shares of stock were registered in his name as paid up. The facts were that the mine was worthless, as M, who had held it under a lease, had discovered. M and W concocted the scheme to sell the mine to the company. This fact was concealed from the directors. On discovering it, by resolution of a majority of the shareholders a bill was filed, in the name of the corporation, to rescind M's 600 shares, to declare the sale void, and to have the shareholders' money restored to them.

M and W called a directors' meeting, and had a motion passed ordering the bill taken from the file. The court ordered the motion to stand over until a meeting could be held to determine the will of a majority of the shareholders. By virtue of bribery and the votes of his 600 shares, M defeated a motion to continue the suit, and the bill was taken off. Thereupon this bill was brought.

Wood, V. C., said: "Upon such a transaction the court will hold the whole contract as a complete fraud . . . If the company knew this gentleman was to have this amount as promotion money, well and good . . . If that had been the case, more might have been said about the frame of the suit. But here is a simple fraud, and nothing else."

"This bill being filed by the plaintiff, on behalf of himself and the other shareholders, it is suggested that the proper course would be to file a bill on behalf of himself and the other shareholders for leave to use the name of the company, in order to set aside that contract. I do not think that circuitous course is necessary under any circumstances. It is quite clear that it is not necessary here, because in this case the purchase of the mines is the only thing for which this company was incorporated . . . The whole thing was obtained by fraud, and the persons who may possibly form a majority of the shareholders could not in any way sanction a transaction of that kind."

A frequent sort of fraud is that in which the majority of the stockholders sell the corporate assets and pocket the consideration, to the exclusion of the minority. Such a case was *Menier* v. *Hooper's Telegraph Works.*[1]

In that case M brought his bill, on behalf of himself and all the other shareholders of the X company, against the H company and the X company, and others, stockholders in the X company. It appeared that the X company was formed for the purpose of availing itself of certain telegraph-cable privileges of the plaintiff, and it was proposed to give the contract for the work of constructing the cable to the H company. 3000 shares of stock were given to the H company, 2000 to plaintiff, and 325 to thirteen other parties, ten of whom were directors. It was believed that the X company had the right to a contract which one A had negotiated with Portugal. A suit in equity was brought to enforce this right, and judgment was given against the company. Both the H company and M at first wished to appeal, but afterwards the H company changed its intention, and, combining with the other stockholders, proceeded to have the X company wound up and a liquidator appointed. Plaintiff protested. It appeared that winding-up would be to the advantage of the H company, because it had contracted with A to procure the said contract with Portugal for itself. The bill prayed that the H company might be declared not entitled to the profits derived by it from the abandonment of the suit and the other arrangements aforesaid, and might be declared a trustee of the profits for all the parties interested.

Sir W. M. James, L. J., said: "The defendants, who have a majority of the shares in the company, have made an arrangement by which they have dealt with matters affecting the whole company, the interest in which belongs to the minority as well as to the majority. They have dealt with them in consideration of their obtaining for themselves certain advantages. . . . I think it would be a shocking thing if that could be done because, if so, the majority might divide the whole assets of the company, and pass a resolution that every-

[1] L. R. 9 Ch. App. 350 (1874).

thing must be given to them, and that the minority should have nothing to do with it."

Sir G. Mellish, L. J., said: "I am of opinion that although it be quite true that the shareholders of a company may vote as they please and for the purpose of their own interests, yet that the majority of the shareholders cannot sell the assets of the company and keep the consideration. . . . . I also entirely agree that, under the circumstances, the suit is properly brought in the name of the plaintiff, on behalf of himself and all the other shareholders."

Mason v. *Harris*,[1] well illustrates the sort of case in which the court considers all the elements requisite to the granting of relief to be present. In that case Harris, by means of fraudulent misrepresentations, sold property to the promoters of the company at a great over-valuation, thus receiving money which ought to be returned to the company if the transaction was affirmed. He had obtained such influence over the directors that a majority sided with him, and would do nothing to remedy the wrong complained of. He also owned so many shares of stock as to be able to outvote the other stockholders, who wished to set the sale aside. The case was held to come directly within the rule of *Atwool* v. *Merryweather*, which was said to have established the exception to the rule of *Foss* v. *Harbottle*.

In this case counsel argued that "a poll might be taken, and if a majority of the shareholders, exclusive of those under the control of the fraudulent persons, were in favor of the action, it may safely be commenced in the name of the company." To this Lord Justice James answered: "That is trying the question of fraud as a preliminary step for ascertaining the frame of the action in which it is to be tried."

The same justice said: "It has been suggested that the court has some means of directing a meeting to be called in which the corrupt shareholders shall not be able to vote. If the court had any such power, that mode of proceeding might furnish the best remedy in cases of this nature, but I cannot

[1] 11 Ch. Div. 97 (1879).

see how any directions for holding such a meeting could be given."

It is to be observed, that in all these cases, the court will make its remedy complete. If it appear that there is no security for the future, but there is danger that those guilty of the fraud will continue to out-vote the minority and mismanage the business, the court has no alternative but to wind up the corporation. For when it is no longer possible for a corporation to fulfil its functions, duties and obligations, it may be wound up: *Miner* v. *Belle Isle Ice Company*,[1]

It is significant to note that the court says, with reference to this point[2]: "The rule applicable in cases of a co-partnership has been held to apply in case of a corporation or joint-stock company."

The court cites *In re Suburban Hotel Company*,[3] where Lord Cairns said: "If it were shown to the court that the whole substratum of the partnership, the whole of the business which the company was incorporated to carry on, has become impossible, I apprehend the court might, either under the Act of Parliament or on general principles, order the company to be wound up."

The use of such language furnishes but another instance of the intimate relation which corporation law bears to the law of partnership. It is but another case where the corporation is held, for all practical purposes, to be a partnership and subject to the same rules as any other body of associates would be. Yet it cannot be denied that though the court uses this language, and though this reasoning and analogy seem perfectly adequate as a basis for the decision, still the court reverts to the over-burdened "trust" theory to support its conclusions in the following language:[4]

"When a number of stockholders combine to constitute themselves a majority in order to control the corporation as they see fit, they become, for all practical purposes, the cor-

[1] 93 Mich. 97 (1892).
[2] At page 113.
[3] 2 Ch. App. 737 (1867), at p. 750.
[4] At page 114.

poration itself, and assume the trust relation occupied by the corporation towards its stockholders."

It is submitted that there is no necessity for any such artificial method of working out the rights of the stockholder. If he be a partner, he has the incidental rights of a partner. But if he be a *cestui que trust*, in any proper sense of the term, why has he not those rights which are incidental to the trust relation? These, as we have seen, he does not possess. Still, the courts do not seem to consider the simple fact of association a sufficient basis for interposition; but, while admitting it as a basis, bolster it up with the theory of a trust. It can as properly be said that a partnership is a trustee for the partners, as it can that a corporation is a trustee for its stockholders. It is submitted that confusion would be avoided, and clearness and simplicity of legal reasoning subserved by the putting aside of this trust theory altogether.

Another case which exhibits the same double basis for its decision is *Fougeray* v. *Cord*,[1] a very interesting case in its facts. There A, B and C formed a corporation to buy land, cut it up into building lots and sell it. They were all equal stockholders and all directors. B and C, in A's absence, voted themselves extravagant salaries, and, in spite of the same, conducted the business so well that the profits were still very large after paying them. B and C, in the name of the corporation, conveyed all the assets of the company to C and then formed a new company, of which A was not a member, to which C conveyed these assets.

A filed his bill to set aside the transfer and for other relief. It appeared that the company was out of debt, except for the services of B and C. After a preliminary hearing of the case, the assets were deeded back to the company and B and C then answered that the property was unimpaired in the company's hands. The court, nevertheless, granted the relief prayed, and ordered a partition of the assets and a winding up of the company, since only in that way could A be adequately protected from a repetition of these fraudulent practices. Another reason why such a decree could be made was that all

[1] 50 N. J. Eq. 185 (1892).

the assets represented profits, so that the stockholders alone were entitled to them. The court, while quoting the language of Hinman, C. J., in *Pratt* v. *Pratt*, to the effect that a trading corporation is little more than a partnership, also laid stress on the proposition that the corporation was a trustee.

The language used was as follows: "In the case of a wilful breach of trust, it (a court of equity) not only compels the guilty trustee to restore the trust property, but removes it from the possession and control of the custodian who has proved untrustworthy. There is nothing in the character of a trading corporation to prevent the application of this remedy. *It is, after all, as between the stockholders, nothing more than a trading copartnership.*"[1]

It was urged on the court, however, that the assets having been returned, nothing could be done. The court replied that when a trustee has proved by his actions that he is unfit to administer the trust, the mere fact that he has righted matters will not deprive it of the power to remove him.

It would seem to be sufficient ground for the dissolution of the corporation that plaintiff could be protected in his interests as a proprietor of the assets in no other way.

It is said, in some of the cases, that anything which amounts to a breach of trust on the part of the directors of the company is sufficient to sustain a suit by an individual shareholder.[2]

These decisions proceed upon the theory that the directors are trustees. This makes the second trust relation that we encounter in dealing with this subject of stockholders' rights. It would seem, according to these views, that (a) the corporation is a trustee for its stockholders, and (b) that the directors are trustees for the corporation. Of the former theory enough has been said. The latter seems to have no very firm basis in logic. If the directors be trustees, they must be trustees

[1] See also the language of Walworth, C., in Robinson *v.* Smith, 3 Paige, 322 (1832), at p. 232, a case cited by Morawetz to sustain the "trust" theory.

[2] Peabody *v.* Flint, 6 Allen, 52 (1863); Robinson *v.* Smith, 3 Paige, 322 (1832).

for the corporation, not for the stockholders.[1] But, as a matter of fact, we know that they have not the duties, characteristics or liabilities of trustees. They do not hold the legal title to any of the corporate assets—so how can they be trustees with reference to them? It is far more reasonable to look upon them as mere managing partners or mandatories, as was done by Mr. Justice Sharswood in *Spering's Appeal*.[2] He said: "It is certain that they are not technical trustees. They can only be regarded as mandatories—persons who have gratuitously undertaken to perform certain duties, and who are, therefore, bound to apply ordinary skill and diligence, but no more . . . I have found no judgment or decree which has held the directors to account except when they have themselves been personally guilty of some fraud on the corporation, or have known and connived at some fraud in others."

As a stockholder may bring the suit where the corporation refuses to do so, so he may defend a suit against his corporation when it, through fraud or collusion on the part of its officers or members, refuses to defend.

In *Bronson* v. *LaCrosse, Etc., R. R. Co.*,[3] A brought a bill in equity to foreclose a mortgage made by the X company. The Y company was made a defendant. The latter company had been organized on a previous foreclosure under a mortgage junior to that under which A claimed to take and operate the X railroad. The time in which the Y company should have answered passed, but before the bill had been taken *pro confesso* against it, B, a stockholder in the Y company, presented a petition to the court alleging collusion between the president and directors to allow the suit to go by default; he prayed to be allowed to defend for the company. He was allowed to file an answer, signed by himself and by the company *per* his own name. On appeal, the Supreme Court held that this was error; for, while B might be admitted to defend his own property rights, he could not defend for the corpora-

[1] Jessel, M. R., in Russel *v.* Water Works Co., L. R. 20 Eq. 474 (1875), p. 479, *et seq.*

[2] 71 Pa. 11 (1872); but see Briggs *v.* Spalding, 141 U. S. 132 (1891).

[3] 2 Wall. 263 (1863).

tion. The only way to compel it to defend was by a writ of *distringas*, and the only person who could so compel it was the complainant in the suit. It was said that, by appearing, the stockholder becomes a real party to the action, and any decree made therein is binding on him and may be enforced against him. The proper method is for him to answer on behalf of himself and all other stockholders who may join him.

It should seem that any decree on the merits, in such a case, would preclude all the other stockholders, if they did not join, from again raising the question, as well as the corporation, which had neglected to answer.

We may then conclude from this summary of the decisions, that on the issue of fraud or oppression, the stockholder has the right to bring a bill in his own name, provided no other way is open for his relief.

2. *EMBARKATION IN A NEW BUSINESS.*

Turn now to another class of cases, in which the remedy under consideration has been invoked, viz.: cases in which it has been sought to embark in new enterprises or enlarge the scope of the business already founded. These are cases dealing largely with the right of a majority. The questions presented by them are very closely related to those which arise in the case of a partnership, and on the same principles as partnership cases they are decided. In this class of cases, the law of partnership has been found exactly applicable to the state of affairs brought to the attention of the court, and has been simply appropriated to the subject of corporations. For the conversion of corporate funds to a different business than that for which the company was organized, there is the same legal remedy as exists in the case of the partnership relation. In fact this amounts to more than a pure question of partnership law. Many acts of this sort, if unauthorized by the legislature, would be *ultra vires;* but such acts will be treated of under the head of *Ultra Vires Acts.*

It may be well to glance first at the law of partnership.

In *Natusch* v. *Irving*,[1] which was a partnership case, and

[1] Supra; Cooper, 358 (1824).

which is continually cited as expressive of the law of corporations, the facts were as follows: Plaintiff's bill was to restrain the president and directors of a marine insurance company, not incorporated, from carrying on the business of fire insurance. The prospectus issued, on the faith of which plaintiff subscribed for shares in the concern, stated that the company was to do only a marine insurance business. The answer of defendants was that a majority of the partners wished the change, and that they were willing to buy plaintiff's shares if he wished to retire.

Lord Eldon said: "If six persons join in a partnership of life assurance, it seems clear that neither the majority, nor any select part of them, nor any five out of six, could engage that partnership in marine insurances, unless the contract of partnership expressly or impliedly gave that power; because if this was otherwise, an individual or individuals, by engaging in one specified concern, might be implicated in any other concern whatever, however different in its nature, against his consent. . . . It may be taken that the principal that would apply to the partnership of six, will apply to this partnership of 600 or 700."

This same principal has been applied to corporations both in England and in this country. The principal of representation does not apply farther than the limits of the purposes for which it was adopted. It will perhaps be simplest to examine the English cases first, wherein the question is not complicated by any doctrine of impairment of the obligation of contract.

The first case in which this ground of decision was taken in England was *Ward* v. *The Society of Attorneys, Etc.*,[1] decided in 1844. There the chartered object of the corporation appeared to be the acquisition of legal knowledge and the promotion of the better and more convenient discharge of the professional duties of its members. A majority of shareholders proposed to sell the realty of the corporation which had been used as a library, surrender the charter, procure a new charter from the crown for a different object, with the feature of unlimited membership, and give all the old stock-

[1] 6 Jur. 1021.

holders shares in the new corporation. Plaintiff, one of the old stockholders, prayed an injunction against the proposed action. The injunction was granted.

Knight-Bruce, V. C., said: "The law allows a corporation having perpetual succession and continuation to be constituted; the law allows subjects, with the consent of the Crown, to purchase that right from the Crown; the law allows individuals to acquire a beneficial interest in the preservation of such a body, so lawfully purchased and constituted. And if these things be so, I am not aware of any principal of law or equity which can enable that lawfully constituted interest thus obtained to be taken away without a provision, either consented to by every person interested, or a provision consistent with the original creation of that institution."

In *Cohen* v. *Wilkinson*,[1] a company was chartered to construct a railway from A to B. This being found impracticable, a majority of the stockholders voted to build the road from A to C,—a very small portion of the road as originally projected. Held, that an injunction would be granted at the suit of a single shareholder against building the said portion only. The Lord Chancellor said: "A railway from A to B might, in the estimation of the plaintiff, have been a good speculation, while the construction of the line for the four miles which the company proposed making might have been considered a very bad speculation."

Very often the question of the stockholder's right is tested before the corporation has done anything under its first charter. The question, then, usually arises in the form of a suit against the stockholder on his subscription to the capital stock of the company. These cases have a direct bearing, since the right of the stockholder to refuse to pay his subscription rests on the same basis as his right to file a bill for an injunction to have the alleged breach of the partnership agreement restrained.

Goldsmid's Case[2] was one of these cases. In that case a prospectus was issued for the establishment of a company. A took shares and paid his deposit for them. Afterwards, at

[1] 1 M. & G., 481 (1849).
[2] 16 Beav. 262 (1852).

a meeting of shareholders, the scheme was greatly varied. The company was formed on the new plan and failed. Held, that A was not a contributary. "He had contracted for a particular company, and if that company had been formed, he would have been a member of it; but it was never formed."[1]

In re Phœnix Life Insurance Company,[2] the facts of *Natusch* v. *Irving* were duplicated to the letter, except that the company was a joint stock company formed under the English Companies' Act. The result was exactly similar to that of the partnership case.[3]

There are, however, several English cases which seem very hard to reconcile with these decisions and with principle, the first of which is *Ware* v. *Grand Junction Water Company*,[4] decided by Lord Brougham in 1831. There the company was formed for the purpose of taking water from the Thames to supply the inhabitants of Paddington. Certain stockholders filed a bill alleging that the company was about to make application to Parliament for an extension of its charter, so that it might take water from the Colne and supply certain other towns, as well as Paddington, with water. The injunction was prayed on the ground that this was a breach of the partnership contract. The Lord Chancellor, after disposing of the objection that this was, in effect, asking for an injunction forbidding Parliament to pass a given act, said: "It is simply an injunction to restrain a partnership, now existing under a certain constitution, from doing any act in its corporate capacity with a view to obtain a new modeling of that constitution—say an extension or a variation, or even a total change of it. I am of opinion that the right to take proceedings in Parliament in the way that is proposed is incident to a corporation of this nature—at the same time fully admitting that the shareholders are certainly not entitled to do anything which the partnership prohibits, or which those acts of Parliament which, in truth,

[1] See also Meyer's Case, 16 Beav. 383 (1852); *Ex parte* Rye, 3 Jur. (N. S.) 460 (1857).

[2] 9 Jur. (N. S.) 15 (1863).

[3] Ffooks *v.* London & S. W. Ry. Co., 17 Jur. 365 (1853).

[4] 2 Russ. & Mylne, 472 (1831).

constitute their deed of partnership, give them authority to do. . . . It was said that, if corporate bodies of this description are allowed to make such an application, those who rely on that constitution are deceived because they came in upon the faith and footing of its being a partnership of a certain kind, and now it is sought to be materially varied. But are not a man's eyes open to the fate that attends him when he enters into a partnership with a body of this kind?"[1]

With some hesitation it is submitted that this decision does not accord with principle. It would seem to be as reasonable to say that a majority of partners in a general partnership have the right to change the object of the partnership, and for that reason a single partner has no right to complain, for that right must be taken to have been a part of his contract, and he runs the risk of that change being made when he joins the firm—as to say that the corporation has the power to apply to Parliament—and, therefore, the member must run the risk of contracting with a body which has such a right. This seems to be reasoning in a circle. It should seem that if the prospectus defined the contract in *Natusch* v. *Irving*, the charter should have defined the scope of the business in *Ware* v. *Water Company;* and any act threatening to change the nature or scope of the business ought to be enjoined. The present case does not seem to be distinguishable in its facts from the others cited. The fact of the corporation being of a quasi-public nature does not seem a reason for distinguishing it. Some of the other cases cited are cases of enlargement or extension rather than absolute change of object; so that the fact that there was a mere enlargement will not distinguish it. Lord Brougham, moreover, does not attempt a distinction on these grounds. He admits the validity of *Natusch* v. *Irving*. The only basis of distinction lies in the supposed peculiar nature of a corporation. It is submitted that this is not a sufficient basis.

Chancellor Bennett, in reviewing the case,[2] says of Lord

[1] This decision was followed in Bill *v.* Sierra Nevada Company, 6 Jur. (N. S.) 184 (1860).

[2] Stevens *v.* Rutland, Etc., R. Co., 29 Vt. 545 (1851).

Brougham's opinion: "I apprehend that the views expressed by the Lord Chancellor in that case, if sound, must rest upon one of two grounds—either that the change asked for in the charter was not a fundamental one, or else upon the ground of the transcendent powers of a British Parliament."

It is submitted that neither of these reasons is sufficient. It is evident that a change could not well be more fundamental than the one proposed. It is also clear that Lord Brougham expressly put Parliament out of the question when the defendant raised the point that such an injunction, if granted, would be a restraint on Parliament's power to grant charters, and rested squarely on the ground that this was a concern of the corporators, and nobody else.

Turning now to the American cases, it will be found that the consideration of this problem is considerably complicated by the confusion with it of the doctrine of constitutional law, which forbids the impairment of the obligation of contracts.

Thus the courts have, in many cases, entirely overlooked the question of private rights involved, in their anxiety to decide the public constitutional question.

One such case was *Schenectady Etc. Plank Road Co.* v. *Thatcher*.[1] It was there said: "It is claimed that the building of the branch road, without the consent of the defendant, released him from his subscription. The general act of 1847, under which the corporation was organized, reserved to the legislature the right at any time to alter, amend, or repeal that act. That power was exercised in 1849 by an act amending the act of 1847 . . . conferring the right upon any plank road company, with the written consent of persons owning two-thirds of the stock . . . to construct branches to their main line, or to extend their main line or change the route of their road or any part thereof. *The defendant subscribed to the stock under the original act, subject to the contingency that additional powers might be conferred or other changes made by an amendment of the law*, and he stands now on the same footing as if his subscription had been made after the amend-

[1] 1 Kern. (N. Y.) 102 (1854).

ment of 1849. It was not offered to be proved that the building of the branch road was prejudicial to the defendant's interests or to those of the corporation."

The italics in the above quotation are the writer's. It should seem that the italicized passage, if it refer to the private contract of association between the members, is wrong, on the grounds stated in discussing *Ware* v. *Water Company;* and if it refer to the contract between the state and the corporation, is wrong, because that contract is not with the defendant but with the corporation. The question would be exactly the same if the power to amend had not been inserted in the act of incorporation; the power to amend was not inserted for the purpose of controlling minority stockholders, but for the protection of the state from the effects of the doctrine of the Dartmouth College case.

From the language following the italicized passages, it will be seen still more clearly that the court took the view that the question at issue was whether the extension of the road would be a breach of the contract between the legislature and the defendant. It is submitted that the question, even in the absence of the repealing clause, is not whether the defendant was injured but whether the partners have availed themselves of the opportunity given by the legislature to do something not comprehended in the original charter. On principle, the question of injury is immaterial.

In a case decided shortly after the above,[1] Parker, J., said: "The right to alter is reserved in the charter, and the subscription must be taken to have been made subject to having such additional powers conferred as the legislature might deem essential and expedient. *The change is not fundamental.* The new powers conferred are identical in kind with those originally given; they are enlarged merely. It must be admitted that under this reserved power to alter and repeal, the legislature would have no right to change the fundamental character of the corporation and convert it into a different legal being, for instance, a banking corporation, without

[1] Buffalo, Etc. R. R. *v.* Dudley, 4 Kern. 336 (1846).

absolving those who did not choose to be bound . . . although the change may have operated to his pecuniary disadvantage, defendant is still bound by his undertaking. It is no breach of the agreement between the plaintiff and the defendant."[1]

It is submitted that it is hard to see how the legislature may enlarge the scope of the business to the admitted damage of the defendant but may not change its character, though the latter act might ultimately prove for his interest.

These cases seem to fix the law of New York though they overrule the decision of Chancellor Kent in *Livingstone* v. *Lynch*,[2] and the decision of the Supreme Court in *Hartford Railroad* v. *Croswell*.[3] It is true that in *Schenectady Co.* v. *Thatcher*, a distinction was drawn between that case and *Hartford R. R.* v. *Croswell*, first, in that in the Hartford case there was no right to amend inserted in the charter, and second, that there was a fundamental change in the business; but it is submitted that the decision was put on the broad ground laid down in the English cases above cited.

Nelson., Ch. J., said:[4] "Indeed, they (corporations) can exercise no power over the corporators beyond those conferred by the charter to which they have subscribed, except on the condition of their agreement or consent. This is so in the case of private associations, where the articles entered into and subscribed by the members are regarded as the fundamental law or constitution of the society, which can only be changed by the unanimous voice of the stockholders."

It is believed that the Massachusetts courts have taken an unsound view of this question, which, though it differs slightly in its reasoning, brings about the same result as does the view of the New York courts. This Massachusetts view is illustrated by the case of *Durfee* v. *R. R. Co.*[5] This case was

[1] To the same effect see: Meadow Dam Co. *v.* Gray, 30 Me. 547 (1849); Banet *v.* Alton & Sangamon R. R. Co., 13 Ill. 564 (1851); Bailey *v.* Power St. Church, 6 R. I. 491 (1860).

[2] 4 Johns. Ch. 573 (1820).

[3] 5 Hill, 383 (1845).

[4] At p. 386.

[5] 5 Allen, 230 (1862).

a bill in equity by a stockholder to restrain the corporation from taking advantage of an act amendatory of its charter. The amendatory act gave the defendant the right to extend its line to a new terminus. Plaintiff's bill was dismissed. Bigelow, C. J., put the decision on two grounds: first, that this was a change only of the extent of the business, and not of its character; and second, that "in creating a corporation no contract is made by the legislature with the individual members or stockholders, any further than they are represented by the artificial body which the act of incorporation calls into being. They have no other rights except those which exist or grow out of the constitution of the body corporate, of which they are members. To this only can we look, in order to ascertain whether there has been any breach of contract or violation of chartered rights. It constitutes, of itself, the contract by which the rights of all parties are to be governed. When, therefore, it is expressly provided between the legislature on the one hand and the corporation on the other, as part of the original contract of incorporation, that the former may change or modify or abrogate it, or any portion of it, it cannot be said that any contract is broken or infringed when the power thus reserved is exercised with the consent of the artificial body, of whose original creation and existence such reservation formed an essential part."

So the ground of the court is, that as the stockholder is one of those who constitute the corporation, and so must exert his rights through the corporation, since the corporation is bound by its contract with the state, he is also bound thereby. It is believed that enough has been said to indicate what is conceived to be the vice of this reasoning.

Not all the American courts have held the views expressed in the cases just cited.

In *Dow* v. *Northern Railroad Company*,[1] we have a decision which, it is believed, expresses the better view of the law in this country. In that case the X R. R. Co. was incorporated to run from A to B. Its charter contained the reserved

[1] 67 N. H. 1 (1887).

power of amendment, repeal, etc. The legislature passed an act authorizing all railroad companies to lease or consolidate with other railroads. A majority of the stockholders of the X Co. passed a resolution to lease to the Y Co., running from B to C. On a bill filed by one of the minority stockholders the lease was held to be void. The language used by the court is very convincing: "It may, indeed, be doubted whether the leasing of the road was not within the power of the majority, but it is submitted that the following extracts from the court's opinion are expressive of the true view of the applicability of the doctrine of the constitutional right of the legislature to compel a stockholder to submit to a change of the business."

Doe, C. J., said: "If a reservation of the power of amending a general or special act of incorporation is a creation and a conveyance to the legislature of a non-legislative power of altering a partnership contract authorized by the same act, the Senate and House, by reservation, can create and acquire the non-legislative power of altering all agreements. 'All future contracts, not made under and in accordance with this act, are prohibited. The power of making a contract under this act is granted to those only who accept and exercise the granted power, with and upon the condition that the contract may be amended by a power hereby reserved and hereby vested in the legislature. This act shall be a part of every contract, and every stipulation excluding it and every device for evading it shall be illegal and void. All law inconsistent with this act is hereby repealed.' "

The Chief Justice then gives another supposed exercise of the legislative power as follows: " 'The partnership agreement of E, F and G to run a daily coach between Concord and Lebanon is hereby amended; a majority of them may assign all the partnership business to H by a lease of all the partnership property for ninety-nine years.' Each of these amendments would be enacted to overcome an objection made by one of the contracting parties, to an alteration of his agreement. The amendments would not be valid unless they were law. If they would be law, they could not be made by the contracting parties, and the original contracts and all other agreements not made by law-makers would be void."

One of the best considered cases in the state courts is *Zabriskie* v. *R. R. Co.*[1] That was a case in which a stockholder took a rule to show cause why an injunction should not issue to prohibit the company from mortgaging its road which had been extended by vote of a majority of the stockholders in pursuance of an act of the legislature of New Jersey amendatory of the original charter of the company. It appeared that the extension of the road and the mortgage in consequence thereof had never been formally laid before the stockholders, but that the directors who authorized them owned a majority of the stock. A decree was asked on the ground that this action of the directors amounted to the embarkation of plaintiff's capital in a new and different enterprise from that for which he had contracted. The Chancellor made a decree enjoining the defendants from extending the road farther than the original terminus named in its charter. The court expressly followed the rule of *Natusch* v. *Irving*, and disapproved of the New York and Massachusetts decisions.

After mentioning the ruling in the Dartmouth College case the Chancellor said, referring to it: "This doctrine did not prevent the legislature from conferring new privileges upon any corporation, to be accepted at is own election." He further said: "When a number of persons associate themselves as partners, for a business and time specified in the agreement between them, or become members of a corporation for definite purposes and objects specified in their charter, which, in such case, is their contract, the objects and business of the partnership or corporation cannot be changed; one partner or corporator, however small his interest, can prevent it . . . And the rule is not changed because the new business or enterprise proposed is allowed by law, or has been made lawful since the association was formed."

In speaking of the cases in New York and Massachusetts, it was said: "They hold that the contract between the

[1] 18 N. J. Eq. 178 (1867).

associate corporators, that they will confine their business to life insurance, is changed by legislative permission to engage in marine insurance, or a contract to join in constructing a railroad from New York to Newark can be changed to one from New York to Elizabeth by legislative consent. The reasoning is founded on the fact that the subscription for the stock, which is the contract, was made, as in this case, under a charter which authorizes a road from Paterson to Hackensack, and authorizes the legislature to alter or modify the act. And from this they infer that it is a contract to join in building any road that the legislature may, by such alteration, authorize the company to build; and that such authority or additional privilege, may be accepted by a majority of the corporators. So far as the alteration is made by the legislature, in a way to be compulsory on the corporation, this is correct, as if they should require the company to build a double track or widen the draws of a bridge . . . . But if the change in the act is simply offering the corporation the privilege of entering upon another and a different enterprise, it is not within the condition of the subscription. The only construction to be given is that the legislature may alter, not the stockholders may as between each other."[1]

This case seems to give a satisfactory answer to the main question; but it still remains to inquire whether there be not some alterations of charters, the acceptance of which by a majority will bind a dissentient minority. Many of the cases have suggested this, and many decided it in a negative manner by implication.[2]

A few have been decided directly on the point. It should seem, however, that the case of a corporation is like that of a partnership. In a partnership, it cannot be doubted that in

[1] See to same effect the well-considered decisions in Kenosha R. R. Co. *v.* Marsh, 17 Wis. 13 (1863); Stevens *v.* Rutland R. Co., 29 Vt. 145 (1851).

[2] Ashton *v.* Burbank, 2 Dill. 435 (1873), where it was said: "The change is . . . . an organic change of such a radical character as to discharge previous subscribers to the stock of the company from any obligation to pay their subscription, unless the change is expressly or impliedly assented to by them." Banet *v.* R. R. Co. (*Supra*); Plank Road Co. Arndt, 31 Pa. 317 (1858.)

matters of detail, of administration, in short, in all matters not pertaining to the nature or scope of the business, the majority of the partners would have a right to decide, and a dissenting minority would be bound by their decision. In the case of a corporation the same rule would appear to hold true. The majority should be able to adopt any amendment of the charter which is not fundamental. This is the view taken by the courts. Thus amendatory acts changing the number of directors may be accepted by a majority.[1]

The decision of each case, then, comes down to a question whether or not the amendment of the charter amounts to a change of the business. It is believed that if the New York cases, cited above, had been put on this ground, they would have been correct in principle though hard to reconcile on their facts. It seems that the extension of a railroad line to a new terminus, or the leasing of another line, or the adoption of a route different from that proposed in the original charter amounts to a change of the business, and ought to require the assent of all the stockholders for its consummation.[2]

Cases in which the legislature reserves the right to amend are, however, to be distinguished from such cases as *Nugent* v. *Supervisors*,[3] which held that where the original charter gives the company the right to amalgamate with other companies and extend its lines, such amalgamation, subsequently accomplished, gives the stockholder neither an excuse for not paying his subscription, nor a right to file a bill for an injunction.

It seems, then, that in this aspect the charter is, as between the stockholders, little more than the articles of association of the partnership are to the partners—the contract which defines the business for them.

As the cases treated under this head are essentially cases of majorities against minorities, the question of preliminary steps necessary to be taken before appealing to the court does not

[1] Joy *v.* Road Co., 11 Mich. 156 (1863); Everhardt *v.* R. Co., 28 Pa. 339 (1857); Mower *v.* Staples, 32 Minn. 284 (1884).

[2] Clearwater *v.* Meredith, 1 Wall. 25 (1863), at p. 40.

[3] 19 Wall. 241 (1873).

arise. If the acts were those of officers or directors, the same rules as to preliminary steps within the corporation would apply as in the case of fraud.

Owen J. Roberts.

(To be concluded.)